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## OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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# Medical Marijuana Fee and Tax System for Collectives and Cooperatives

## OVERVIEW

On December 8, 2009, the Medical Marijuana Task Force reported its land use and zoning recommendations to the City Council (Report No. 09-165). The report contained specific land use and zoning recommendations for collectives and cooperatives within the City, including the employment of a conditional use permit process, zoning limitations, non-profit status verification, and requirements relating to distance, security, lighting, and signage. In general, the Task Force recommendations acknowledged that medical marijuana collectives and cooperatives should be closely regulated to ensure safe access for qualified patients while discouraging illegitimate operations.

The implementation of the regulations associated with medical marijuana collectives and cooperatives would place an additional workload on City staff time and resources. A number of cities with medical marijuana ordinances have established fees to recover the administrative and regulatory costs associated with collectives/cooperatives. In one case, the City of Oakland has established a new business tax to generate revenue from medical marijuana operations to support general City services. This report will review fees for consideration by the Task Force for recommendation to mitigate the costs associated with the legal establishment of collectives and cooperatives within the City, in addition to tax revenue options.

## FISCAL/POLICY DISCUSSION

### Fee Structures in Other California Cities

For this report, the IBA reviewed the fees of cities and/or counties with ordinances allowing for the recognition and establishment of medical marijuana collectives and cooperatives. For the purposes of illustration, fee structures within the City of Oakland,

County of Los Angeles, County/City of San Francisco, and City of Santa Cruz were selected for summary within this report. Although as of August 2009, the City of Santa Cruz has implemented a moratorium on collectives/cooperatives, the fee structure in place prior to the moratorium is included in this review for discussion purposes.

The fees associated with the application and approval process for medical marijuana collectives/cooperatives ranged from \$2,010 for initial applications within the City of Santa Cruz, to \$11,245-\$33,756, within the City of Oakland. The fees collected cover costs associated with the various levels of the application review process. The costs recovered varied by city, but generally, fees were charged to cover the costs for the application, permit & license administration, public hearings, inspections, documentation, and departmental reviews.

The departments involved in the administrative and regulatory process for medical marijuana collectives and cooperatives differed across the cities sampled. The process in the City of Santa Cruz was solely handled by its Planning Departments. In contrast, the City of Oakland, County of Los Angeles, and County/City of San Francisco processes involve multiple departments. In the City of Oakland, the Office of the City Administrator, Police, Fire, Planning, and Financial Services Departments handle various aspects of the application review and approval. The County/City of San Francisco employs its Departments of Health, Building, and Fire. In the County of Los Angeles, the Planning Department and the County Treasurer & Tax Collector are involved, with the Treasurer & Tax Collector coordinating the involvement of other departments such as Building and Safety, Fire, and Health, as necessary.

**Attachment 1** provides further detail on fee types, costs, and administering departments for each of the cities reviewed.

#### Fee Structure within the City of San Diego

Per Council Policy 100-05, fee amounts can be established to recover the cost of a service provided. Setting a fee requires the determination of the actual direct and indirect costs associated with the service through a fee study. City departments are responsible for setting the cost recovery rate and level in accordance with the policy. New fees must be approved by the City's Chief Operating Officer, reviewed by the Budget and Finance Committee, and approved by the City Council.

The recommendation of specific fees for medical marijuana collectives/cooperatives within the City of San Diego would require a determination of the requirements for the approval of collectives/cooperatives within the City, and the departments that would be involved in the approval process. Once this is determined, those departments would need to conduct a fee study to assign costs to their required administrative and/or regulatory duties, based on the specific personnel or non-personnel costs particular to each.

Though policies have not been codified within the City of San Diego regarding the approval process for medical marijuana collectives/cooperatives, there are fee systems that have been implemented for businesses that sell regulated substances that can serve as an example for possible approval processes.

One such example is the permit process for tobacco product sales. Businesses that sell tobacco products are required to receive a police permit to operate within the City. As a police regulated business, aside from applying for a business tax certificate, tobacco product retailers are subject to investigation and regulation in order to qualify for a police permit allowing them to conduct business within the City. In the application process, the applicant must supply information for background verification, and the Police Department has the authority to grant or deny a police permit based a review of the applicant's fitness to operate a tobacco retail business. The Application Fee for a Tobacco Retailer Permit is \$104, with a Regulatory Permit Fee of \$108, totaling \$212 for an initial application.

As another example, per Section 141.0502 of the Municipal Code, certain alcoholic beverage outlets are subject to administrative review as a part of the application process for a Beer and Wine or General Liquor License with the California Department of Alcoholic Beverage Control. Such a review involves verifying that the outlet meets location specifications relating to the crime rate, distance from other outlets, distance from sensitive uses, and residential property. The fees associated with this application process are: a \$591.00 Application and Review Fee, \$20.00 Records Fee, and \$10.00 Mapping Fee.

The tobacco retailer's permit and alcoholic beverage outlet administrative review process are highlighted here solely for illustrative purposes, and are not meant as specific recommendations relating to medical marijuana collectives and cooperatives. The fee charged and the amounts will differ depending on the extent of the administrative and regulatory requirements. The Development Services Department, has indicated that obtaining a Conditional Use Permit for medical marijuana collectives and cooperatives could cost from \$15,000 to \$30,000 for staff time. This is just a preliminary estimate as the application cost would vary depending on a number of factors including the regulations imposed, level of controversy involved, public contact, and the associated appeals.

#### Business Taxes

Where applicable, under each reviewed jurisdiction's tax structure, business taxes apply for collectives/cooperatives. Business taxes are differentiated from fees given that they are purposed for revenue generation aside from cost recovery. In accordance with the California State Constitution, initiating a new tax associated with medical marijuana collectives/cooperatives would require a majority vote of the San Diego electorate if the

revenue is to be used for a general purpose, and a two-thirds vote, if the revenue was allocated for a special purpose.

So far, the City of Oakland is the only California jurisdiction that has proposed and successfully implemented a business tax increase for medical marijuana collectives/cooperatives. Measure F, approved by an 80% majority vote in 2009, established a new business tax rate for “Cannabis Businesses”. The proposition increased the tax applied to gross receipts from business activity from \$1.20 per \$1,000 to \$18 per \$1,000. The original tax rate was a general rate applied for retail sales businesses at \$60.00 annually for the first \$50,000 in gross receipts, and \$1.20 per \$1,000 above \$50,000. The City of Oakland has four licensed collectives/cooperatives that are projected to generate \$315,000 in revenue from the business tax in the 2010 calendar year. This is based on projected gross receipts of \$17.5 million at the new tax rate. The revenue generated will be allocated for general purposes.

The current business tax rate that would apply to collectives and cooperatives within the City of San Diego is \$34 dollars for establishments with 12 or fewer employees, and for larger establishments, \$125, plus \$5 dollars per employee. Currently the Police Department estimates that there are 90 store-front medical marijuana collectives/cooperatives within the City. Assuming that each of these establishments have less than 12 employees, and were all legally recognized, \$3,150 in tax revenue would be collected for the City with the current business tax structure.

#### Sales Tax Revenue

In February 2007, the State Board of Equalization (SBOE) issued a special notice clarifying that medical marijuana sales are subject to sale and use taxes and that sellers of medical marijuana are required to apply for and hold a seller’s permit. Those that fail to obtain a seller’s permit or do not report and pay sales and use taxes are subject to interest and penalty charges. A January 2010 special notice to sellers of medical marijuana highlighted that sales made without a seller’s permit are subject to a look-back period of eight years. According to the SBOE, compliance levels for the attainment of seller’s permits statewide are not high.

In general the City of San Diego receives 1% of the 8.75% of sales tax that is generated for all taxable sales transactions within the City. The tepid climate within the City relating to the legal recognition of medical marijuana collectives and cooperatives, has likely contributed to low seller’s permit compliance rates within the City. An effort to audit sales tax remittances to the State to recover which establishments do not have seller’s permits and/or are not collecting and remitting taxes could recover sales and use tax due to the City. Currently, information on the average medical marijuana sales by collectives and cooperatives within the City for use in calculating potential annual sales tax receipts is unknown given the limited information that is reported at this time.

### Fee and Tax Exemptions Associated with Non-Profit Status

Per The State Attorney General's August 2008 "Guidelines for the Security and Non-Diversion of Marijuana Grown for Medical Use," it is stipulated that collectives and cooperatives are to operate in a non-profit manner to ensure lawful operation. Within the San Diego Municipal Code, there is specific language exempting certain non-profit organizations from being required to pay business taxes, police permit fees, and processing fees or deposits for Conditional Use Permits. Those sections of the Municipal Code as pertaining to (1) business taxes, (2) police permits, and (3) development permits, follow respectively.

#### ***(1) §31.0201 Exceptions — Charities — Public Well-Being***

*No business tax shall be levied nor certificate of payment be issued under the provisions of this Article to any of the following:*

*(a) Any charitable institution, organization or association organized and conducted exclusively for charitable purposes, and not for private gain or profit. The issuance by the California Franchise Tax Board of a certificate of exemption from state income taxation shall conclusively establish the exempt status of any such entity.*

#### ***(2) §33.0601 Exempt Institutions***

*The provisions of this Article shall not be construed to require the payment of any permit fee by any federal, state, county or municipal organization, or any non-profit organization, organized and qualified under the laws of the United States or California as a tax-exempt organization. The issuance of a tax-exempt certificate by the California State Franchise Tax Board shall be conclusive evidence of such exempt status.*

#### ***(3) §112.0203 Waiver of Fees or Deposits***

*(b) Processing fees or deposits for Conditional Use Permits and Neighborhood Development Permits are waived for nonprofit institutions or organizations whose primary purpose is the promotion of public health and welfare and who have qualified for federal tax benefits. This waiver does not apply to institutions or organizations in circumstances in which the City is precluded by the California Constitution from making a gift of City funds.*

Each of these sections of the Municipal Code must be dealt with separately to make a determination of whether medical marijuana collectives and cooperatives qualify as exempt operations, and therefore preclude the collection of business taxes and permit fees from them.

If the City Council were to decide to establish a regulatory process for the existence of collectives and cooperatives in the City, it would have to address policies regarding the imposition of fees and taxes. Depending on the Council's direction, the City Attorney would have to review the legal distinctions regarding the exclusion of collectives and cooperatives from exempt status. As appropriate, this issue must be addressed as part of the ordinance outlining the regulatory process for collectives and cooperatives.

## CONCLUSION

Given the degree of administrative and regulatory oversight associated with medical marijuana collectives and cooperatives, it is necessary that an appropriate fee structure is established within the City to recover the additional costs that would be incurred. Tax structures are also present to generate additional revenue to support general city services. This report provides information relating to the fee and/or tax structures that have been implemented within other California cities and that are currently present within the City to advise on possible options for implementation with respect to collectives and cooperatives. Policy decisions regarding specific departmental involvement in the application and regulatory process must be codified first in determining the cost burdens to the City. The IBA recommends that the Medical Marijuana Task Force gives consideration to the appropriate regulatory structure for collectives and cooperatives to better inform any recommendations on the most appropriate fee structure for implementation by the City. Ultimately those departments that are involved in the process would have to conduct fee studies to inform the fee level.

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Attachments:

1. Medical Marijuana Fees